No. 2821

In the United States Circuit Court of Appeals

For the Ninth Circuit

A. R. TITLOW, as Receiver of the United States National Bank of Centralia, Washington, and the United States National Bank of Centralia,

Appellants,

vs.

THE CITY OF CENTRALIA, a Municipal Corporation,

Appellee.

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION.

BRIEF OF APPELLANT

R. P. OLDHAM,
R. C. GOODALE,
Attorneys for Appellants.
1408 Hoge Building, Seattle, Washington.

Sherman Printing & Binding Co. 71 Columbia Street, Seattle

INDEX

No. 2821

In the United States Circuit Court of Appeals

For the Ninth Circuit

A. R. TITLOW, as Receiver of the United States National Bank of Centralia, Washington, and the United States National Bank of Centralia,

Appellants,

vs.

THE CITY OF CENTRALIA, a Municipal Corporation,

Appellee.

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION.

BRIEF OF APPELLANT

STATEMENT

The City of Centralia issued certain water works bonds which it had sold to Carstens & Earles, of Seattle. On July 11, 1914, Mason, the city treasurer, delivered these bonds to the United States National

Bank, together with a sight draft drawn by Mason on Carstens & Earles for collection. The bank forwarded the bonds, with the draft attached, for collection and credit, to the National Bank of Commerce, one of its reserve agents and correspondent banks at Seattle (39). The Seattle Bank made the collection on July 13th (40). The amount was $50,911.88, and on that day the National Bank of Commerce credited the United States National with this and other items aggregating $55,000 (90). At that time the United States National was overdrawn with the National Bank of Commerce to the extent of some $11,000, so that after securing this credit on July 13th, of $55,000, including the item of $50,911.88 in dispute in this action, there was at close of business on July 13th a credit on the books of the National Bank of Commerce to the United States National Bank of $37,409.59 (77). Exhibit A (77) shows the state of account between these two banks from July 11th to July 22d. From this exhibit in general it appears that the United States National was making certain deposits and certain withdrawals from the Seattle bank, and that on July 22d the United States National had overdrawn its account and was indebted to the National Bank of Commerce $632.77. The United States National utilized the credit that it had with the National Bank of Commerce between July 11th and July 22d, as

stated by the trial judge (32) in the ordinary course of business, and it "was drawn upon by the United States National Bank of Centralia, Washington, in carrying on its banking operations." Now, the books of the United States National showed that it still had a credit with the National Bank of Commerce until July 28th (42), on which date an overdraft occurred. It is immaterial whether we take the books of the Seattle bank or the Centralia bank in this connection. The Seattle bank's books would show the *actual* condition of the account between the two banks. The Centralia bank's books would include items that might have been in transit between the two banks. In any event, the credit that the Centralia bank had with its Seattle correspondent was exhausted in four different ways (89-111):

1. By drafts which were drawn by the Centralia Bank on its account with the Seattle bank in favor of creditors of the Centralia bank.

2. By the Seattle bank's cashing checks and other items drawn on the Centralia bank by Centralia's depositors.

3. By the transfer by the Centralia bank of a credit of approximately $20,000 to the Continental Bank in Chicago, and a transfer of other credits from

the Seattle bank to the credit of the Centralia bank with correspondents in Tacoma.

4. There were charged back to the Centralia bank certain discount notes aggregating nearly $15,000, which notes were (a) charged to Centralia's depositors' accounts, or (b) exchanged for renewal notes taken by Centralia and rediscounted by it with other banks and exhausted by subsequent ovedraft by Centralia.

There was *no cash or securities of any kind transferred* directly or indirectly from the National Bank of Commerce to the United States National or its receiver as representing the proceeds of this collection.

On September 19, 1914, the United States National became insolvent. The comptroller appointed a receiver on September 21st.

At the time of its insolvency, the United States National had cash on hand $27,000, together with various cash items, amounting to $5,000 (100), $1,000 of which had been collected, the remaining $4,000 were uncollectible (102).

There was deposited in actual cash over the counter of the United States National Bank from July 28th to September 19th, $130,000 (99). The total claims of creditors were $1,200,000. A 100% assessment has been levied against all stockholders, and there are

not sufficient assets of the bank to pay creditors in full. There were preferred claims asserted against the insolvent bank aggregating over $100,000 (111-114).

The city treasurer, Mason, was credited by the United States National with the $50,911.88. He was notified of the credit on July 21st by the United States National (49). This account was subject to check and he was paid interest on it (50).

Other facts we do not deem material, but which the respondent does, are as follows:

Between July 13th, the date the collection was made at Seattle, and September 21st, the date of the insolvency of the United States National, the lowest amount of cash on hand, together with cash items in the vaults of the Centralia bank, was about $22,000, on August 5th (47). The lowest amount of cash on hand and due from reserve agents was on September 17th of $70,000.00 (47).

The United States National was designated as a city depository, but Mason had failed to get a bond from the bank sufficient to cover this account as required by law (49).

SPECIFICATION OF ERRORS

1. The District Court erred in finding and adjudging that the deposit of funds of the city with the defendant, United States National Bank of Centralia, without obtaining the bond required by the statutes of the State of Washington to secure their repayment, was sufficient to establish a trust relation or any other relation than that of debtor and creditor between the United States National Bank and the City of Centralia, or to give rise to a preferred claim against the bank upon its insolvency and failure to repay such funds.

2. The District Court erred in finding and adjudging that the sum of $50,911.88, representing the proceeds of the sale of water bonds of the plaintiff city, or any part of such sum, was ever actually traced into the possession of the defendant bank or its receiver, or resulted in augmenting the assets of the bank coming into the hands of the receiver, or was used for any other purpose than the payment of the debts of the defendant, United States National Bank of Centralia.

3. The District Court erred in rendering a decree allowing a preferred claim to the plaintiff in the sum of $44,553.09, which decree is contrary to the testimony and against the law, because the equities

of the case entitled the defendants to a decree of dismissal.

4. Even if the circumstances under which the plaintiff city's funds were deposited originally were such as to entitle it to a preferred claim, the District Court erred in finding and adjudging that that claim should be paid in full, and in directing the defendants to pay it without first ascertaining what proportion, if any, of the funds of the defendant bank on hand at the time of its failure was properly applicable to the payment of this claim, in preference to other preferred claims which the evidence shows were and are being urged against the defendant bank and its receiver.

5. Even if the proof showed that the circumstances under which the plaintiff's funds were originally deposited with the defendant bank were such as to create a preferred claim, and the funds were sufficiently traced so that that right to a preferred claim still subsisted at the time of the failure of the bank, the District Court nevertheless erred in finding and adjudging that the plaintiff was entitled to a preferred claim in any greater sum than the lowest amount of actual cash in the vaults of the defendant bank at any time between the date of the city's deposit and the day of the bank's failure.

ARGUMENT

General Observations

The right of the city to receive preferential payment out of the assets of the insolvent bank to the detriment of the general creditors must be based upon the principle that the proceeds of the collection formed a trust fund and that this trust fund was directly traceable to the assets which passed to the receiver.

Your Honors will bear in mind the following:

1. The collection was *not made directly by the United States Bank.*

2. The collection involved was made *three months* prior to insolvency.

3. No part of the collection either in cash or other thing of value was shown to have come into the possession of the bank or its receiver.

The decision of the trial court rests upon the now discredited and repudiated theory that in order to establish a trust fund against an insolvent bank it is only necessary to show that its receiver has obtained sufficient funds to pay it. In other words, that a trust will be decreed against *all the assets* of the bank. In furtherance of this theory, the trial court held that it was immaterial whether or not the proceeds of the collection found its way into the *actual*

possession of the United States National but that when the collection was made through its correspondent, the National Bank of Commerce, it was in fact received by the United States National; that it made no difference what subsequently became of this fund if the receiver had sufficient assets to pay the claim. The trial court rests its decision on Your Honors' ruling in *Merchants' National Bank vs. School District,* 94 Fed. 705, to which case we shall have occasion hereafter to refer.

The rationale of decision of the trial court repudiates the modern doctrine universally laid down by the Federal Courts and by the Supreme Court of the United States.

"They (claimants to trust fund) were under the *burden of proving their title;* if they were unable to carry the burden of identifying the fund as representing the proceeds of their Interborough stock, their claim must fail. If their evidence *left the matter of identification in doubt, the doubt must be resolved in favor of the trustee who represented all of the creditors. (Schuyler vs. Littlefield,* 232 U. S. 710.)"

And in *City vs. Litchfield vs. Ballou,* 114 U. S. 190, the same court said:

"If the complainants go after the money they let the city have, they must *clearly identify* the money or the fund or other property which represents that money in such a manner that it can be re-claimed and delivered

without taking other property with it, or injuring other persons, or interfering with others' rights."

Your Honors have said:

"There is no recognized ground upon which equity can pursue a fund and impose upon it the character of a trust except upon the theory that *the money is still the property of the plaintiff.* If he is permitted to follow it it is because it is his own whether in the form in which he parted with its possession or in a substituted form. (*Spokane County vs. First National Bank,* 68 Fed. 979.)"

In a more recent case you said:

"But it is a general rule, as well in a court of equity as in a court of law, that in order to follow trust funds and subject them to the operation of the trust, *they must be identified.* (Citing authorities.) In carrying out the rule, when it comes to *proof, the owner must assume the burden of ascertaining and tracing the trust funds,* showing that the assets which have come into the hands of the trustee have been directly added to or benefitted by an amount of money realized from the sales of the specified goods held in trust, and recovery is limited to the extent of this increase or benefit. * * * So funds *that have been dissipated or that have been used to pay other creditors, or that have been spent to pay current business expenses, are not recoverable,* because they are gone and there is nothing remaining to be the subject of the trust." *In re Acheson,* 170 Fed. 427

In *Empire State Surety Co. vs. Carroll County,* 194 Fed. 593, C. C. A. 8th Cir. That court said:

"It is indispensable to the maintenance by a *cestui que* trust of a claim to preferential payment by a receiver out of the proceeds of an estate of an insolvent,

that *clear proof* be made that the trust property or its proceeds went into a specific fund, or into a specific, identified piece of property, which came into the hands of the receiver, and then the claim can be sustained to that fund or property only, and only to the extent that the trust property or its proceeds went into it. *It is not sufficient proof* that the trust property or its proceeds went into the *general* assets of the insolvent estate and increased the amount and value thereof which came into the hands of the receiver."

Tracing the Fund

With the above general observations let us apply these well recognized principles to the case at bar. *Has the city assumed and carried the burden of proof* of tracing and identifying any mone yor other assets in the hands of the receiver as the proceeds of the sale of the bonds to Carstens and Earles. The fact is the contrary. *The receiver has assumed the burden* which the Supreme Court and Your Honors have said rests upon the *claimant.* He has shown that *none of the fund* or its proceeds went from the National Bank of Commerce either to the bank or its receiver. The evidence affirmatively shows that the fund was actually dissipated prior to insolvency. It is true that as a matter of creating the relation of *debtor and creditor* the receipt by the correspondent bank is receipt by the United States National, but *the fact is* that no funds or credits in the hands of the Centralia bank were mingled with any balance in the National Bank of

Commerce. Can the court say that the $27,000 in cash in the vaults of the Centralia bank contained any part of the collection made in Seattle? Was any part of these cash items of some $5,000 which passed to the receiver, and of which the evidence shows $4,000 are uncollectible, a part of this asserted fund or the proceeds from it? Surely this cash on hand cannot belong to two claimants.

Your Honors have said recently, August 7, 1916, that $1,296 of it belong to one Sundquist. The trial court has said that $10,000 of it belong to one McCormick. And the record discloses that preferred claimants to the extent of $100,000 all claim that this money is theirs (111-114).

Now the proceeds of the City's collection went in the form of a credit to the United States National in the National Bank of Commerce at Seattle. A part of this was immediately used in wiping out a debt which the United States National had with the Seattle bank on July 13th. For, after depositing the proceeds of this collection and other items aggregating in all $55,069.77, the balance in favor of the United States National in the Seattle bank was $37,409.59 at the close of business on July 13 (76). Had that fund remained with the Seattle bank until the insolvency of the Centralia bank and had been paid to

its receiver, the trust fund might be said to have been traced. But *that is not the fact.* We are concerned then with the state of the United States National account with the Seattle bank. This, in turn, is limited to the period of time ending July 22d, or at the most July 28th, when that account was wiped out and an overdraft occurred. What may have been the *subsequent* dealings between the United States National and the National Bank of Commerce is of no concern. This was the view of the trial court and it was correct.

As said in *Board of Commissioners vs. Strawn* (157 Fed. 49, C. C. A. 6th Cir.):

"It is therefore a part of the rule applicable to following appropriated money into a bank account that, if at any time during currency of the mingled account the trusts used had left a balance less than the trust money, the trust money must be regarded as dissipated except as to this balance, the sums subsequently added to the account from other sources not being attributed to the trust fund."

What Became of This Credit Balance in the Seattle Bank

Remember that this fund started with $43,998.13 on July 13th. The trial court said it was used:

"In the ordinary course of business this balance was reduced by withdrawals, by draft directly from the United States National Bank, by the National Bank of Commerce cashing checks upon the United States National Bank drawn by its depositors and

by drafts drawn by the United States National Bank in favor of other correspondent banks and reserve agents until, on July 22d, 1914, according to the books of the National Bank of Commerce, the account was again overdrawn."

Between the dates of July 11th and July 28th the City's own testimony (57) shows that the Centralia bank shifted credit balances from the National Bank of Commerce to only *three other banks,* although in the transaction of its business the Centralia bank was during that time keeping accounts with *at least twenty-five other banks* (44, 59). These three to which the transfer of credit in favor of the Centralia bank occurred were as follows:

$62,500 to the Bank of California at Tacoma. $20,000 to the Continental and Commercial National Bank of Chicago, and $15,000 to the Bank of Italy at San Francisco, aggregating $97,500.

It would be a violent assumption to say that the City's collection was a part or all of this $97,500 so shifted to the other three banks, but we will show your Honors that even these transfers of credit to the three banks in Tacoma, Chicago and San Francisco were soon dissipated and never reached the Centralia bank in any substituted form or thing of value.

Eliminating for the time being these transfers of credit to the three banks above specified let us return to the remaining balances in the Seattle bank.

National Bank of Commerce

The withdrawals from this account are itemized in defendant's "Exhibit A" (77). See also Exhibits G and H. They are explained in the testimony (90). $12,225, represented three notes of $3,610, on July 13th, and two notes of $4,870 and $3,745 on July 15th. These three notes were what was known as Wallville paper and acceptances by the Eastern Railway and Lumber Company. They had been discounted with the United States National and then re-discounted by that bank with the National Bank of Commerce. On the respective due dates the three notes were charged back to the United States National and sent that bank. Now, did the United States National in turn *collect the notes?* If it had and the funds had remained in the hands of the bank and its receiver it might be said that so much of this fund of $50,000 had been directly traced. But the testimony shows that these notes were not only *not collected* but also that *they again passed out of the United States National* and were absorbed by overdrafts in other banks (90). These notes formed part of an issue of $20,000. After the return of the three above notes to the United States

National a new issue by the same makers and acceptors took the place of the old ones. But this new issue was made up of different amounts and exactly what became of these items it is impossible to say. Two of the renewal notes, aggregating $8,000, were re-discounted at the National Bank of Commerce on July 23d. Two more, aggregating over $8,000 were re-discounted at the Continental & Commercial Bank of Chicago, another one of approximately $5,000 was sent to the First National of Portland (91). The two that went back to the National Bank of Commerce were credited by that bank to the United States National on July 23d, and on July 29th the United State National *was again overdrawn* with the National Bank of Commerce (91). The one that was sent to the bank at Portland was credited on July 23d but six days afterward the United States National was overdrawn at the Portland bank (92). The two that went to the Chicago bank were sent out on July 23d and were credited by the Chicago bank to the account of the United States National about eight days afterward. As to this account with the Chicago bank we shall refer to hereafter. The city had tried to trace these three notes and was unable to do so (70).

The next items on this Exhibit down to the $10,000 withdrawal on July 14th all fall under the head of

the withdrawals that were made as stated by the trial court "by the National Bank of Commerce cashing checks upon the United States National Bank drawn by its depositors." The customary method would be that a depositor of the United States National desiring a draft would draw his check on his own account in the United States National and secure a draft on the Seattle correspondent. *This, of course, was a direct withdrawal of funds.* The United States National was paying its debts to other creditors, it was dissipating it credit balance.

Then came the transfer of credit, aggregating $20,000 to the Continental & Commercial Bank of Chicago on July 14th. On the 15th, $7,500 was transferred to the Bank of California, Tacoma, and $10,000.75 on that date to the Continental & Commercial Bank of Chicago.

All the other withdrawals down to an item of $2,500 on July 21st were of the same nature as the petty withdrawals already explained, by minor drafts purchased by customers and the cashing of checks by the National Bank of Commerce, drawn on the United States National.

The $2,500 withdrawal on July 21st was a discount note of the Chester Snow Company which had been charged back to the United States National and

the note was returned to the United States National upon its falling due. Upon its return to the United States National it was carried by that bank until July 28th when it was *charged to the account of the maker,* the Chester Snow Company, who was a depositor in the United States National. It appears that the Chester Snow Company was overdrawn and indebted to the United States National, at the time of insolvency, to the extent of $80,000 (98). The depositor is in the hands of a receiver and it is doubtful if it will even pay preferred claims (98). *The bank has never collected anything from that company or from anyone else on account of it* (98).

The next few withdrawals, on July 21st and 22d, up to the time of the overdraft consisted in the main of three large items, $4,941.83, $400.92 and finally $2,948.75. These three withdrawals represent the payment of checks drawn on the United States National by its depositors (98, 99). If we continue this examination of the account in Seattle until July 28 when the account was overdrawn, according to the Centralia bank books, we will find the credit was being exhausted in a similar method. Exhibits G and H, Record p. 9104.

Summary of Withdrawals from National Bank of Commerce

Summarizing the exhaustion of credit that the United States National had with the National Bank of Commerce between July 11th and 22d, we find that it was exhausted in three ways.

First. By various banks honoring checks drawn by depositors of the United States National on their respective accounts in the United States National. Simplified this means the payment of the United States National's debts to its depositors. The amount of the credit thus exhausted was $45,533.42.

Second. The return of re-discounted paper, Wallville $12,225 and Chester Snow $2,500, being a total debit of $14,725, all of which paper became dissipated or worthless and was never collected by the United States National.

Three. By the transfer of credits to three other correspondent banks (See post 14).

Other withdrawals of this credit balance is limited to items of less than $100. They are small. It is sufficient to state that the testimony (92-99) shows that none of these small items were transfers of money or other thing of value to the United States National.

They usually represented purchases of drafts by depositors of the bank.

Transfer to Bank of California at Tacoma

Between July 11th and 22d there were credit transfers from the Seattle bank to the Bank of California in Tacoma aggregating $35,000 (69). There were other heavy transfers between July 22d and July 28th. The United States National during this period was constantly overdrawn with the Tacoma bank. On July 20th the overdraft of the United States National with the Bank of California was $8,241.54, on the 21st it was still overdrawn $2,524.62, on the 24th of July it was $3,004.54, on July 29th the overdraft was $1,213.68 (109-110). See also (69). It thus appears that with the heavy overdraft in the Bank of California the United States National was paying that creditor by a transfer of heavy credits that it had with the National Bank of Commerce.

The Bank of Italy at San Francisco

The receiver obtained nothing from this source for at the time of insolvency it appeared that the United States National was indebted to the Bank of Italy in the sum of $5,900 for which amount that bank has filed a claim against the receiver (100). The City of Centralia has failed to trace any transfer or

other thing of value from the Bank of Italy to the United States National.

Continental & Commercial Bank of Chicago

The credit balance with the Chicago bank was exhausted on August 6th when the United States National had an overdraft of $13,047.39 and there is no testimony that there was a transfer up to that time of funds or anything else of value to the United States National (70).

Our Authorities

A bank is not like the ordinary trustee. In mingling supposedly trust funds *it is not mingling* the trust *res* with its own funds. The bank is the debtor of many persons. If the trust fund is mingled, it is mingled with the *funds of other depositors.* Therefore, if one creditor is to be paid in full this preferential payment must be made not at the expense of the *bank* but of *other creditors.*

The city is driven to the following position:

That the credit once obtained at a correspondent and reserve bank will be *presumed* to have passed into the hands of the receiver so long as credit balances remain and pass to the receiver from *all other* correspondent banks of the insolvent.

It boldly asserts that it does not care what became of the credit after the Seattle bank gave proper credit therefor to the Centralia bank. It says: "You at least used that credit balance to pay your creditors," and the facts show that the payment of the Centralia bank's creditors *was the very use made of the credit balance.*

If the receiver obtained from the Northwest National Bank of Minneapolis (one of the United States National reserve agents, 44) any funds, is there any legal fiction that will fasten to that fund a trust in favor of the city?

With the burden resting upon the city to trace and identify the proceeds of her collection either in the original form or in some substituted form, it is not sufficient that it show a mere augmentation or swelling of assets, nor is it entitled to a lien against the *general assets* in the hands of the receiver. It is the city's duty to trace, by *clear* and *satisfactory* proof, the trust *res* in the receiver's possession. Some of the earlier cases, including those from this circuit, fell into error in this respect, as we will show later.

This general rule is stated in *Peters vs. Bain,* 133 U. S. 670, which was a suit to recover misappropriated trust funds. Bain & Company, a copartnership in control of the Exchange National Bank, had appropriated practically all the assets to their own purposes. That

was a suit by the receiver of the bank to impress a trust on the assets of the partnership, which had assigned for the benefit of creditors. The property which was sought to be recovered fell into two classes, the first relating to property which was purchased with moneys that could be *identified* as belonging to the bank, and second, that which was bought and paid for by the firm out of a *general mass* of moneys in their possession, and which *may* or may not have been made up in part of what had been wrongfully taken from the bank. The trust was held established as to the first property, which was directly traceable to the assets of the bank. As to the second class the court said:

"Some of the money of the bank *may have gone into this fund*, but it was not distinguished from the rest. The mixture of the money of the bank with the money of the firm did not make the bank the owner of the whole. All the bank could in any event claim would be the right to draw out of the general mass of money, so long as it remained money, an amount equal to that which had been wrongfully taken from its own possession and put there. Purchases made and paid for out of a general mass cannot be claimed by the bank, *unless it is shown that its own moneys then in the fund were appropriated for that purpose.*"

In *Empire State Surety Co. vs. Carroll County,* 194 Fed. 593, C. C. A. 8th Cir., Judge Sanborn states four rules governing this class of cases:

"1. The claimant must prove clearly that the trust property or its proceeds went into a specific

fund or specific property, which came into the hands of the receiver. It is not sufficient to prove that the trust property or the proceeds went into the general assets and increased the amount coming to the receiver.

"2. If trust funds are mingled in a common fund, and payment is made out of that fund, claimant can recover not exceeding the smallest amount the fund contained subsequent to the commingling, since the presumption is that the trustees kept the trust fund sacred.

"3. For this reason the legal presumption is that promissory notes and other paper coming into the hands of the receiver were not procured by the use of trust property.

"4. Where the property of many *cestuis que* trustent is mingled, and payment made out of the common fund, the presumption is that the moneys were paid out in the order they were paid in, and *cestuis que* trustent are entitled to preference in the inverse order of their payments into the fund. First in, first out."

That case involved various claims founded upon different facts. Judge Sanborn said:

"They next claim that they are entitled to preferential payment of about $12,000.00, first, because $4,455.05 was owing on the notes discounted by the Bank between June 11, 1908, and October 17, 1908, which came to the hands of the receiver, but the claim to such an allowance on account of these notes is forbidden by the third rule and by the fact that there is no evidence tracing any of the county deposits or any of the proceeds of them into any of these funds; second, because the receiver collected $1,763.77 *from credits to the First National Bank in other banks,* but no preference on this account may be allowed for the same reason; and third, because $5,912.05 in cash came into the hands of the receiver

when the bank failed, but the allowance of a preference on this account is forbidden by the fourth rule, and by these facts: All of the deposits of the county were made prior to October 10, 1908, except a deposit made on that day of tax receipts aggregating $1,041.22, and checks of third persons aggregating $486.11, and a deposit made on October 17, 1908, of $1,604.88 in checks. It was for these two deposits that the preference of $3,132.21 was allowed to the sureties by the court below. But this record has been searched in vain for any evidence that the checks for the $1,604.88 deposited on the last day the bank was open ever went into the hands of the receiver, and no claim is made to recover these checks, nor can any evidence be found sufficient to show what banks these checks were drawn upon, or that any moneys derived from them ever went into the $5,912.05 or into the hands of the receiver. Proof that these checks augmented the cash that went into the hands of the receiver, or that they produced cash which he obtained, was indispensable to any preference on their account. But checks of third persons on the bank with which they are deposited, which are paid by crediting the bank and charging the drawers on the books, fail to increase the cash in its possession, and form no basis for preferential payment to the depositor. *Beard vs. Independent District of Pella City,* 88 Fed. 375. Moreover, the deposit of checks of third persons which are credited to the depositor and used by the bank to pay its debts, bring no money into its fund of cash, and form no foundation for preferential payment to the depositor. *City Bank vs. Blackmore,* 75 Fed. 771. Again checks of third parties, deposited with the bank credited to the depositor, and collected through a clearing house, lay no foundation for a preferential payment, in the absence of proof of them, for they may have been and usually are used, in whole or in part, to discharge the debts of the bank (citing authorities). These

checks may have been, and the probability is much greater than most of them were, used for some of these purposes than it is that cash for them was paid into the bank and remained there at the close of the day and went into the hands of the receiver."

An analogous case to the one at bar was that of *American Can Co. vs. Williams,* C. C. A., 2d Cir., 178 Fed. 420. Preference was claimed against the receiver of an insolvent bank on the following grounds: Plaintiff forwarded to the Fredonia Bank for collection certain drafts on two local corporations, aggregating some $28,000. The bank collected the drafts in the following manner: First, drafts paid by the drawees' check on outside banks, made payable to the Fredonia bank, and subsequently *paid directly to defendant as receiver.* Second, drafts paid by the drawees' checks on outside banks, made payable to the Fredonia bank, and paid by the former to the latter *before* the appointment of a receiver. Third, drafts paid by the drawees out of their accounts as depositors of the Fredonia bank. *Fourth, drafts paid by the drawees' checks on outside banks made payable to the Fredonia bank, and indorsed and delivered by it to the Merchants Exchange National Bank of New York City, and credited by the Merchants bank to the Fredonia bank.*

Your Honors will perceive that the fourth state of facts is identical with those at bar.

It was further *conceded* in the case that

"At all times mentioned in the complaint prior to the 20th day of June, 1905, the assets of the Fredonia Bank and the assets which came into the defendant's hands as receiver and which are now in his hands, exceeded the amount of the plaintiff's claim."

The court assumed that the proceeds of certain of these drafts did come into the possession of the bank *before* the receivership *and constituted trust funds* in its hands, but the court says:

"The difficulty is, upon the agreed statement of facts, in following such funds into the hands of the receiver. *It may be* that prior to the receivership the bank used the trust fund to pay its debts with. It may be that these funds were wholly dissipated. *There is absolutely nothing to show that they had any connection with any of the property which came into the possession of the receiver.* The stipulated facts are wholly insufficient to show *any identity* of the property followed with the funds sought to be charged against it, or to show that the amount of such property was increased or augmented by such funds. While the right to follow misapplied moneys as trust funds into the hands of a receiver has been extended in the modern decisions, there has never been in the federal courts a departure from the principle that there must be some identification of the property followed with the trust funds. * * * If the plaintiff's contention is well founded, that to follow misappropriated moneys it is only necessary to show that a receiver has, and that the trustee had, assets, the rule is simply that a demand for such moneys is a preferred claim against any substantial estate, and to adopt this view would do away with all the equitable principles out of which the right to follow trust funds grew."

In *City Bank vs. Blackmore*, 75 Fed. 771, C. C. A. 6th Cir., it appeared that the plaintiff City Bank sent a draft on August 24, to the Commercial National Bank of Nashville. The draft was drawn on Latham & Co., of New York, and was for $5,000.00. The Commercial Bank, then insolvent, received the draft August 25, credited the City Bank, and immediately sent the draft to the Bank of the Republic, its New York correspondent, to be deposited to the Commercial Bank's credit. Later in the day, August 25, the Commercial Bank was closed. The New York bank credited the draft to the Commercial Bank August 27. The City Bank stopped payment on the draft August 26. Accordingly the drawee refused to pay, but later, by direction of the City Bank, paid when the New York Bank brought suit against the City Bank on the draft. The City Bank then presented a claim to the receiver and asked that $5,000 be allowed as preferred. Judge Taft, in holding the City Bank not entitled to priority, said:

"But the difficulty with the complainant's position is that neither the draft nor the proceeds of the draft have come into the receiver's hands. The sole question is therefore whether the *credit* thus secured by the Commercial Bank and its receiver by the draft entitles the City Bank to take $5,000 out of the assets held by the receiver. The question must certainly be answered in the negative in any view which can be taken, unless it appears that the assets were in-

creased $5,000 by the credit, or that the claims against them were so decreased that there was $5,000 *more for distribution* among those who remained creditors after the credit than there would have been had no credit been given to the Commercial Bank for the draft. This does not appear. If no such credit had been allowed by the National Bank of the Republic, it would merely have been a claimant for $5,000 more and would have been entitled, not to $5,000 in full, but only to pro rata dividends on that amount. The benefit to the general fund from the draft, therefore, is limited to the amount of dividends payable on the $5,000.00, and that amount the receiver has already allowed to the City Bank. It has no ground for complaint, therefore. No authority has been cited to show that a claim founded on fraud is entitled to *priority* over other claims. It is only where, by rescission of the contract out of which the claim arises on the ground of fraud, that the specific thing parted with or its proceeds can be sufficiently identified to be returned, that fraud seems to give a priority of distribution."

The opinion was concurred in by Mr. Justice Lurton.

By depositing a collection with a correspondent bank, does it make any difference whether the *debt to the correspondent bank* is reduced, or whether the *credit* with the correspondent bank is used to *pay other creditors?* In both instances the fund is lost. There is no greater amount for distribution among the general creditors. Instead of making A a creditor of the bank, B is made a creditor, and the substitution of parties is the only thing accomplished by the paper transaction. This question of tracing trust funds

against an insolvent was recently before the Supreme Court in *Schuyler vs. Littlefield,* 232 U. S. 710. The same case in the lower court, *In re Brown,* 193 Fed. 24. In the Circuit Court of Appeals the facts appeared as follows:

The bankrupts, Brown & Co., had converted certain stock belonging to the Princeton Bank. From the proceeds of the stock, Brown & Co. deposited $1,120 in the Bank of Commerce and $280 in the Hanover Bank. These transactions were on August 17 and August 24. The bankruptcy occurred at noon, August 25. The bankrupts also sold other stock of the Princeton Bank, and on August 13 had deposited the proceeds, $1,787, in the Hanover bank. As to Brown & Co.'s deposits in the Bank of Commerce, it showed that there was a balance in favor of the bankrupts from August 17 to 24 largely in excess of $1,120. The balance August 25 was $21,000 but this was exhausted by checks subsequently presented, and the trustee received no money from that account. It further appeared that on August 25, though Brown & Co. had transferred $4,000 from the Bank of Commerce to the Hanover Bank by check, there was nothing to show that the $1,120 trust funds were included in this check and reappeared in the balance of $2,000, *which balance the trustee in bankruptcy received from*

the Hanover bank. As to the deposit in the Hanover bank, the claim of the Princeton bank against this fund aggregated $280, plus $1,787, making a total of $2,067. The balance on the books of the Hanover Bank in favor of the bankrupts on and after August 13 to August 24 *was largely in excess* of the sums due the Princeton bank. It was held, however, that a trust fund was not established, that there was nothing to show that these balances represented the trust money of the Princeton bank rather than the trust money of various other persons urging similar claims aggregating $21,000. There was also nothing to show but that during the same day the balance had been entirely wiped out and the trust fund lost, and subsequent deposits would not make it good.

Your Honors will see the amazing similarity of the facts in the *Brown* case to those in the case at bar. *First.* The insolvent was dealing with two correspondent banks, in which correspondent banks the trustee had deposited the funds in dispute. *Second.* The alleged trust fund was represented by mere credit balances due the insolvent. The *Brown* case contains these *additional* facts, which were *favorable* to the claimant. *First.* The fund of $4,000 had been transferred from one of the depositories to the other. *Second.* The trustee of the insolvent actually received in

cash over $2,000 *after insolvency* from the second depository. As to the insolvent's account with the Bank of Commerce, that court said:

"If $1,120 of the claimant's money was left in that bank, it has been dissipated and can be traced no further."

The claimant then asserted that by the transfer of the $4,000 from the Commerce bank to the Hanover bank, his trust fund was *thereupon transferred to the Hanover bank,* and that the trustees in bankruptcy admittedly *received in cash the sum of* $2,055.97, *this cash receipt included the claimant's* $1,120. That court said:

"This seems a very tenous presumption *in the absence of any evidence to support it.* The amounts are different. There is nothing to show that there was a sum of $2,880 trust money of some sort with which the claimant's $1,220 was being shifted by the bankrupts, for some unexplained reason, from one bank to another. As we said in *In re McIntyre,* Grace's appeal, 185 Fed. 96, 108, C. C. A. 540, while the doctrine of following trust funds has been much extended in modern decisions, there has never been a departure in the Federal courts from the principle that there must be some identification of the property sought to be charged with the trust fund. * * * The special master finds that 'The opening and closing balances in the Hanover bank on and after August 13, were largely in excess of these (2 deposits), *but the finding is not sufficient.* There is no reason why it should be *assumed* that these balances were being reserved because they represented the trust money of the Princeton bank rather than because they represented the trust

money of Simpson or Scrotton or any of the others similarly situated, enumerated above (aggregating $21,-783.39), or indeed any of the other claimants who from time to time have appeared in this proceeding seeking to trace and recover for property converted by the bankrupt. Moreover, it is not enough to show that there was a morning and afternoon balance for several successive days large enough to cover that amount of money which was improperly converted. It might very well be that on any one day checks were presented which exhausted the morning balance and its accretions, in which event these moneys would have been dissipated. We are not prepared to assent to the proposition that subsequent deposits are to be taken as having been made to make good claimant's money thus drawn and spent. *Board of Commissioners vs. Strawn,* 157 Fed. 51."

This case was affirmed in the Supreme Court in *First National Bank of Princeton vs. Littlefield,* 226 U. S. 110. The same case was also before the Supreme Court of the United States as to another claimant *sub nom Schuyler vs. Littlefield,* 232 U. S. 710.

The city relies upon *Commercial National Bank vs. Armstrong,* 148 U. S. 50. Same case, in the lower court, 39 Fed. 684, and a recent decision of the Circuit Court of Appeals for the Sixth Circuit, *Brennan vs. Tillinghast,* 201 Fed. 609.

To both of these cases we call the Court's respectful attention. Both cases are strong authorities for the defendants, recognizing that before one is entitled to a preferential claim, the trust fund must be clearly traced

and identified in the hands of the receiver, and the assets of the insolvent estate swollen to the extent of such fund. Both cases repudiate the doctrine that the payment of debts of the insolvent bank is either (a) a tracing of the fund, or (b) an inncrease of assets in the hands of the receiver.

In the Armstrong case a Philadelphia bank had a contract with a Cincinnati bank covering collections to be made on behalf of the Philadelphia bank. Some of these collections were to be made directly by the Cincinnati bank. Others were to be sent by the Cincinnati bank to its subagents for collections. The three questions as stated by the lower court under the facts in that case were, "1. What under their contract and course of business was the relation created by the two banks in respect to the commercial paper which complainant sent to the Fidelity bank for collection? 2. What if any change or modification of that relation was made or effected as to the proceeds of such paper as actual collections thereof by the Fidelity bank or its correspondent? and, 3, how far or to what extent can complainant follow and impress on the proceeds of such paper a trust such as will entitle it to recover out of the funds in the hands of the receiver?"

The lower court decided in answer to Question 1 that the relation of principal and agent existed. In

answer to Question 2, that after collection made the relation of debtor and creditor existed, and the third was referred to a special master who reported the facts as follows:

Said funds were mostly collected by "subagents of the Fidelity bank; that such subagents, having mutual accounts with the Fidelity bank, credited the latter with the amount of such collections, and at the date of the Fidelity bank's suspension it had credit balances with some and debit balances with others of such subagents." And further, that in those cases where there was a credit balance with such subagents, the accounts between said Fidelity bank and *such correspondents* exhibited a *continuous balance* due the former from the latter, down to the date of the Fidelity's failure, *as large or larger than the amount of the proceeds of complainant's said paper so collected and credited by said correspondents, and that after the receivership these amounts were subsequently paid over to and received by the defendant,* i. e., the receiver. For the amount, to-wit, some $7,209.59, so collected by the subagents of the Fidelity and *paid over* by said subagents to the receiver of the Fidelity, the plaintiff was allowed a preferential claim. The balance of plaintiff's claim was allowed as a general creditor.

The Supreme Court in passing upon these facts said as to the paper handed subagents for collection by the Fidelity,

"The subagent collected it and held the specific money in hand to be delivered to the Fidelity bank. Then *the failure of the Fidelity came and the specific money was handed to its receiver.* That money never became a part of the general fund of the Fidelity. *It was not applied by the subagent in reducing the indebtedness of the Fidelity to it, but it was held as a sum collected* to be paid over to the Fidelity, or to whomsoever might be entitled to it."

At the time of the insolvency (of Fidelity) *"it had not fully performed its duties as agents and collected it. It had not received the moneys collected by its subagent. They were traceable as separate and specific funds, and therefore the plaintiff was entitled to have them paid out of the assets in the hands of the receiver; for when he collected them from these subagents he was in fact collecting them as the agent of the principal."*

It is true that court said that when the subagent made the collection and credited the amount thereof to the Fidelity, the moneys practically passed into the hands of the Fidelity, and that it was the same as if the money had actually reached the vaults of the Fidelity, but Your Honor will observe that this was for the purpose of determining in plaintiff status as a *general* creditor. That by such transaction plaintiff had a right

to assert a *general claim* for the money collected either by the Fidelity directly or by its subagents; for that Court further on says:

"We think, however, a more satisfactory reason is found in the fact that by the terms of the arrangement between the plaintiff and the Fidelity, the relation of *creditor* and *debtor* was created when the collections were fully made."

The decision of the lower court was affirmed, allowing plaintiff a *preferred* claim *only to the extent* that collections had been made by subagents, and *the amount of such collections paid over by the subagent to the receiver.* Where the collections had been made by the subagents and *credited* to the account of the Fidelity, and this credit account exhausted prior to the insolvency of the Fidelity, the trust fund was held dissipated, and plaintiff relegated to the position of a general creditor.

The Armstrong case has been frequently cited by the Federal Courts on the question that a collection item sent by one back to another creates a relation of principal and agent until collected. That upon collection the relation changes to that of debtor and creditor.

Judge Taft, in *City Bank vs. Blackmore,* C. C. A., 75 Fed. 771, in which opinion Judge Lurton concurred,

cited the Armstrong case. In the Blackmore case the plaintiff sent to the insolvent bank an item for collection. This item was sent by the insolvent bank to the New York bank for collection and deposit. The New York bank collected the item and deposited its proceeds to the credit of the insolvent bank. The credit thus given by the New York bank reduced a debt owing it by the insolvent bank. The plaintiff claimed a preferred claim. The Court said:

"If the draft had come into the hands of the receiver, it would have been his duty and the court below would have doubtless compelled him to deliver the draft to the complainant, *but the difficulty with complainant's position is that neither the draft nor the proceeds of the draft came into the receiver's hands.* The sole question is therefore whether the *credit* thus secured by the Commercial bank and its receiver by the draft entitles the City bank to taking $5,000 out of the assets held by the receiver. The question must certainly be answered in the negative in any view which can be taken, unless it appears that the assets were increased $5,000 by the credit, or that the claims against them were so decreased *that there was* $5,000 *more for distribution among those who remained creditors after the credit, than there would have been had no credit been given to the Commercial bank for the draft. This does not appear.* If no such credit had been allowed by the National Bank of the Republic, it would merely have been a claimant for $5,000 more, and would have been entitled not to $5,000 in full, but only to *pro rata* dividends on that amount."

"It may not be necessary to show earmarks upon the proceeds of the thing parted with to justify such

remedy, but it must at least appear that the funds in the hands of the receiver were increased or benefitted by the proceeds, and the recovery is limited to the extent of this increase or benefit. In every case relied on by counsel for appellant recovery, if decreed, was based on the fact that the property in the hands of the assignee or receiver of the person or bank against whom the claim of fraud, right to rescind and priority of distribution was made, *included in its mass either the very thing parted with or its proceeds. Armstrong v. Bank,* 148 U. S. 50."

The Circuit Court of Appeals in the Fifth Circuit, in *Richardson vs. Louisville Bank,* 94 Fed. 442, said that the instant case was controlled by *Bank vs. Armstrong,* and the complainant below was entitled to a decree for all items not *collected* by the American National Bank *before suspension,* and *afterwards* collected by subagents, *and traced to the possession of the receiver.*

In the Richardson case it appeared that a large number of the items had been collected *directly by the receiver* from the subagent banks. The same circuit decided the case of *Richardson vs. New Orleans,* 102 Fed. 785, and said:

"In *Bank vs. Armstrong,* 148 U. S. 50, a bank holding paper for collection passed into the hands of the receiver. The court held that the relation between bank and depositor as to uncollected paper was that of principal and agent, and that the money collected on the

paper *after the bank had closed, which* had not been commingled with the general fund in the bank, could be reclaimed."

The Armstrong case was again cited in *Board of Commissioners vs. Strawn,* 157 Fed. 49, C. C. A., which was a suit to impress a trust on the assets of an insolvent national bank, of some $48,000, being certain taxes collected by the cashier of the bank. It was *admitted* that the fund was a trust fund, and the only question was whether it could be traced.

"That the mis-use of this trust fund has gone to swell in one form or another the general assets of the bank is not enough to charge the whole with a lien, will not be seriously contested. The cases which deny such a contention are numerous, to impress upon a trust on a property of tortfeasor who has used the trust fund in his private affairs. It must be traced in its original shape or substituted form." (Citing the Armstrong case).

In the Brennan case the Ironwood bank wrongfully sold shares of stock belonging to the plaintiff. The proceeds of $3,500 the Ironwood bank deposited with the Duluth bank. The American Express Company purchased drafts of the Ironwood bank amounting to $2,800. These drafts were paid for by the American Express Company, and the drafts were drawn on the Duluth bank. The express company paid the Ironwood bank the amount of these drafts *in cash over its*

counter. The balance that the *Ironwood bank always carried with the Duluth bank was in excess of the* $3,500, the amount of money received from sale of plaintiff's stock. The court recognizing the necessity of tracing trust fund, held that when money actually passed over the counter of the Ironwood bank of $2,800, it was in effect a transfer of that much of the trust fund in cash into the Ironwood bank, *and to that extent the trust fund would be traceable.* Another interesting feature in the Brennan case was that the transactions above referred to occurred between May 1st and May 8th. The bank failed three days afterward, May 11th.

Decisions in This Circuit

The City will cite to Your Honors *Merchants National Bank vs. School District* (94 Fed. 705). The collection there was placed to the credit of the Helena bank in Boston. $15,000 of this credit that Helena had with Boston was transferred to New York. A preferred claim was allowed. Your Honors said:

"The question is not complicated by any failure on the part of the Boston bank to pay the Helena bank *in full the amount which it received. The Helena bank received the money in the due course of business."*

In view of the statement of the Court above quoted and the condition of the record (see transcript of

record in that case, pages 56 and 59), it appears that the Helena bank either received the actual money, the proceeds of the collection, or that this money released securities from the Fourth National Bank of New York *which actually passed into the hands of the receiver.* The main question in the Helena case was whether or not the proceeds of the collection was a trust fund. The question of *tracing the fund* was not seriously considered by counsel on either side or by the court. The only Federal citations by the receiver were:

Philadelphia Bank vs. Dowd, 38 Fed. 173.
Bank vs. Armstrong, 39 Fed. 684, and
Bank vs. Insurance Company (not applicable), 104 U. S. 54.

The claimant in that case cited *Commercial Bank vs. Armstrong* (148 U. S. 59), purely on the question of special deposit. He cited at length *San Diego County vs. California National Bank* (52 Fed. 59), where a trust was decreed against the *general assets of the insolvent bank* without an attempt to trace the fund. The San Diego case was repudiated by *Multnomah vs. Oregon National Bank* (61 Fed. 912). It was criticised in *re Marsh* (116 Fed. 396) and in *re Mulligan* (116 Fed. 715). Judge Gilbert in the Spokane County case (68 Fed. 979), said that the San Diego case among others laid down a doctrine to which this court could not assent. It was followed by the lower court

in the Beard case (83 Fed. 14), which was reversed by the Circuit Court of Appeals in 88 Fed. 375. Judge Sanborn in the Carroll County case (194 Fed. 604), says that the doctrine of that case and some others is "sustained neither by reason nor authority."

The claimant also relied on *Massey vs. Fischer* (62 Fed. 958), in which case Massey handed the cashier of the bank $1,225 *in actual money for a specific purpose.* This money was *put into a drawer in the bank.* This occurred on April 30th. On May 8th, nine days afterward, the bank failed with $34,000 cash on hand. At no time during the two dates did the bank have less than $24,000 cash on hand.

The remaining case relied upon by the claimant in the Helena bank case was *Cleveland vs. Hawkins* (79 Fed. 29), which decreed a trust against all the assets of the insolvent bank. That case, however, was promptly reversed by the Circuit Court of Appeals in 89 Fed. 266.

Counsel for the City would construe the decision to mean that the proceeds of the School District's collection was dissipated in the ordinary exchange of credits between banks. It is preferable to give the case that construction which renders it consistent with the prior and subsequent decisions of Your Honors and

with the overwhelming weight of authority elsewhere. That is, that the Helena bank did receive *the proceeds of the collection,* as stated by your honors, and as shown by the record.

Finally, there is the case of *Morcland vs. Brown* (86 Fed. 257). That decision is criticised in 12 Har. Law Rev. 221. That case is not an authority for the one at bar for the following reasons:

First. There was an *express refusal* on the part of the plaintiff to have any *contractual relations with the Helena bank* which subsequently became insolvent.

Second. The wrong in that case *was committed by the receiver.* He co-operated with the New York bank in appropriating the $2,600 belonging to the plaintiff. This $2,600 reduced the balance which the Helena bank owed the New York bank and thus *enabled the receiver to release* $100,000 *worth of securities* by the payment of $4,000 instead of $6,600 which he would have had to pay if the plaintiff's deposit had not been appropriated. In other words, by utilizing plaintiff's deposit *there actually came into the hands of the receiver securities of far greater value.*

Fallacy of Treating Balances With Reserve and Correspondent Banks as Assets

The City says that there should be treated as cash,

not only the actual cash in the vaults of the bank but the balances carried with reserve agents. It states that the insolvent Centralia bank *carried cash* with its reserve agents and cites a Federal statute relative to lawful reserve.

Now an examination of this statute discloses that a National bank may keep its lawful reserve in two ways:

(a) Either actual cash on hand in the vaults of the bank, or

(b) A certain per cent. of actual cash on hand and *balances* or credits of a certain per cent. with certain authorized correspondent banks. (R. S. 5191 and 5192).

"Three-fifths of the reserve of 15 per centum required by the preceeding section to be kept, may consist of balances due to an association, available for the redemption of its circulating notes, from association, approved by the Comptroller of the Currency, etc."

The trial judge adopted claimant's theory, treating these balances due from reserve agents and correspondent banks *as cash on hand.* No authority can be cited to sustain this contention with the exception of a few early Federal and State cases since overruled or disapproved. By adopting such a view all collection items

of an insolvent bank would become trust funds. *The general depositors would receive nothing.* The court would have to resort to legal fiction and overlook the actual facts. As an illustration, it appears that among these balances due was over $5,000 from the Bank of Italy at San Francisco on September 19th when the bank failed (102). But not only was this credit balance wiped out by counter charges but the Bank of Italy *actually filed a claim and was one of the creditors of the insolvent bank* (102) *to the amount of* $5,900 (100).

Again let us suppose that the United States National was carrying all three-fifths of its lawful reserve, say $150,000, in the shape of a balance due from one reserve agent. That after the failure of the United States National *this reserve agent failed,* paying ten cents on the dollar. Would the United State National be a preferred claimant against its reserve agent? No. One bank is simply a depositor in the other bank. The relation is that of an ordinary depositor, debtor and creditor. The fact is, the balances due from reserve agents and correspondent banks *are not cash* but are what the statute says, to-wit, balances due. The court is not justified in disregarding this fact and treating these balances as cash.

Did the transaction between the bank and the city

create any other relation than that of purely debtor and creditor?

On this question there is a conflict of authority, but there are some special reasons in this case upon which the court might well hold that the question of a trust fund is immaterial. Plaintiff relies upon the failure of the city treasurer to give a bond covering this deposit, and that the bank of course knew that under the law he was compelled to give bond for city deposits. The city therefore says that a peculiar relation existed which created an exception to the rule that a depositor in the bank is its creditor.

The court will recollect that the collection was made July 13th. It was not until August 31st that the city made any inquiry about it, and at that time the treasurer received the pass book with the amount credited to his account, just the same as any other depositor in the bank. Further it is shown that the bank *paid interest* on this account up to the time of its failure. Ordinarily speaking, a trustee who wrongfully deposits funds of his *cestui que trust* in the bank has no greater rights against the bank upon its insolvency than that of a general depositor. It is also a well-known principle that where one has my money and pays me interest for the use of the money, the relation between the parties is that of debtor and creditor.

The city was acting wrongfully (through its treasurer). The bank was acting wrongfully in receiving the deposit without the proper bond. The parties were *pari delicto*. Should the general depositors of this bank be deprived of their proper dividends for the wrongful act of the city treasurer?

There is not doubt that the well reasoned cases on the subject hold that the relation is that of debtor and creditor.

Beard vs. Independent Dist. of Pella City, 88 Fed. 375, C. C. A. 8th Cir.
McNulta vs. West Chicago Park, 99 Fed. 900.
In re Salmon, 145 Fed. 649.

The early cases general gave municipal corporations preference for any deposit whether rightfully or wrongfully made. At the present time there is a diversity of opinion among the courts as to the right to treat a municipal depositor as a special one when it was wrongfully made. Why should the municipality have any superior right over the ordinary trustee of funds who wrongfully in breach of his trust deposits with the bank? In the last case it must be conceded that the trustee or the *cesstui que trust* has no greater rights than that of a general depositor.

Form of Decree

The form of decree is objectionable in failing to take into account other preferred claims established

or in process of being established against the receiver.

In *Lucas County vs. Jamison,* 170 Fed. 338, the court said:

"But the court knows that there is still another on its docket in which a preference of more than $100,000 is asked; so it will be seen that if preferences could be allowed in these cases, then the other cases involving so large an amount might cover the same funds."

In *Cherry vs. Territory,* 89 Pac. 190 (Okla.), which is in other respects pertinent, the court said:

"But when the evidence in the particular case shows affirmatively that a party stands in the same position as others, as for instance in a receivership matter, and the court is passing upon the priority of claims, it should consider the effect of the particular judgment upon the other creditors similarly situated."

Clark Sparks and Sons vs. Americus Nat. Bank, 230 Fed. 738.

CONCLUSION

We respectfully submit that complainant's position is sustainable only by an adoption of the discredited principle of impressing a lien upon all the assets of the delinquent trustee, regardless either of augmentation of the assets or identification of the fund. We have not found it necessary in this case to point out the apparent difference of opinion among the courts as

to whether more augmentation is sufficient without identification; and this for two reasons:

1. There was no swelling of the assets coming into the hands of the receiver in this case on account of the misappropriation, therefore the necessity for pursuing the inquiry as to whether that element alone is sufficient does not arise.

2. Even if the question were involved, it is not an open one in the Federal courts, as the authorities hereinbefore and hereinafter cited abundently show.

The defendants assumed a burden which the law does not impose upon them, and affirmatively established that the trust res did not come into the hands of the bank. In view of this fact, the circumstance that the bank had on the various dates when the trust res was converted some separate fund into which the record shows the trust res did not come, is immaterial. The complainant having failed to point out either actually, or presumptively any res in the possession of the receiver to which it can assert a *property right,* its claim to any specific fund or piece of property must fail.

Upon the necessity of identification of the particular trust res sought to be reclaimed, in addition to the authorities hereinbefore cited, we beg to refer the court to the following:

Litchfield vs. Ballou, 29 L. Ed. 132; 114 U. S. 190.

Peters vs. Bair, 133 U. S. 670, 678, 679.

Re Smith, Etc. Co., 159 Fed. 268, D. C. Wis., affirmed C. C. A., 7th Circuit, 170 Fed. 900.

Re See, 209 Fed. 172, C. C. A., 2d Circuit.

Re Ennis, 187 Fed. 728, C. C. A., 2d Circuit.

Philadelphia National Bank vs. Dowd, 38 Fed. 172, C. C. N. C.

Board of Commissioners vs. Strawn, 157 Fed. 49, C. C. A., 6th Circuit.

Re Mulligan, 116 Fed. 715, D. C. Mass. (quoted with approval by Gilbert, J.)

In re Dorr, 196 Fed. 292, 298.

Re Marsh, 116 Fed. 396, D. C. Conn.

Beard vs. School District, 88 Fed. 375, C. C. A., 8th Circuit.

Lucas County vs. Jamison, 170 Fed. 338, C. C. Iowa.

Metropolitan National Bank vs. Commission Co., 77 Fed. 705, C. C. Mo.

Re Larkin, 202 Fed. 572, D. C. S. D.

Multnomah County Case, 61 Fed. 912, Ore.

Gault vs. Hospital, 89 Atl. 105, Md.

Cushman vs. Goodwin, 50 Atl. 50, Me.

Bellevue State Bank vs. Coffin, 125 Pac. 817, Idaho. (This case contains a full citation of authorities.)

Red Bud Realty Co. vs. South, 131 S. W. 340, Ark.

Hewitt vs. Hayes, 91 N. E. 332, Mass.

Little vs. Chadwick, 23 N. E. 1005, Mass.

Lowe vs. Jones, 78 N. E. 402, Mass. (This case was cited with approval in the Acheson case, 170 Fed. at 430. It contains a particularly illuminating discussion of the principles now under investigation.)

We think it not improper to advert to the importance of the case at bar to the receiver, and to the effect which an adverse decision will have upon the administration of his trust, especially in respect to the collection of outstanding debts due the insolvent bank. It involves to a very singular degree the welfare of this receivership. The fact that a complainant seeks to be preferred over three thousand other creditors, and that the establishment of its claim will be attended by consequences so injurious to numerous other persons alike unfortunate, may, it seems to us, properly be taken into consideration to the extent of requiring it to establish ~~her~~ it right by clear and convincing proof. And if the court shall feel any doubt upon the facts proved and the authorities cited, as to whether it has sustained the burden which the law imposes upon ~~her~~ it, as the Supreme Court of the United States said in *Schyler vs. Littlefield,* 232 U. S. 707, 713; 58 L. Ed. 806, 809, "the doubt must be resolved in favor of the trustee, who represents all the creditors."

Respectfully submitted,

R. P. OLDHAM,
R. C. GOODALE,
Attorney for Appellants.